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THE CEO's SECOND WIFE

How she changes the man — and the manager

*Dress designer
Carolyn Roehm,
whose husband
is Henry Kravis*

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FORTUNE



ABOVE: Nancy and Norman Brinker were photographed at their Twin Mallets Ranch in Texas by Theo Westenberger/Sygma.

COVER: Theo Westenberger/Sygma photographed Carolyn Roehm in front of a 17th-century Flemish tapestry in the Trustees' Room at the New York Public Library.

EXECUTIVE LIFE Cover Story

THE CEO'S SECOND WIFE

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Yes, she's typically younger than the first, and she's different in other ways. Often she has a substantial career. At the same time, she's a showpiece: beautiful, slim, and sometimes taller than her husband. But her primary job is remaking his life. The change he undergoes in her hands may even result in his becoming a more considerate manager.

by Julie Connelly

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"I see really happy people. They've corrected for past mistakes."

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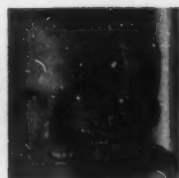
It's plastics. Sooner or later the stuff turns into the kind of garbage that takes eons to degrade. Manufacturers ignored the solid-waste crisis, and now they face bans that could be hard on them—and their customers, who include just about everybody.

by Stratford P. Sherman



"We're going to have a bear market... I expect a drop of 20% in the U.S. market."

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If an English boss says, "Perhaps you ought to think about this a little more," what he means is "You must be mad."

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"From all I've seen, there's been nothing to shake my confidence in the DC-10."

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"Plastic is forcing us to take responsibility for the way we live!"

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EDITOR'S DESK



Cover writer Connelly examines business sociology.

WHAT IN THE WORLD is FORTUNE doing writing about second wives of CEOs? Henry Luce, who knew something about the subject, started us on this course in 1930 with the very first issue of FORTUNE, which pioneered in reporting on business sociology. Ever since then our magazine has examined, among many other subjects, how managers' personal lives intertwine with their careers. Assistant managing editor Walter Kiechel, who edited "The CEO's Second Wife," says, "This story recounts in Proustian detail how the lives of people at the top have changed and tells us something about what they are thinking."

The writer of our cover story, senior editor Julie Connelly, is a veteran of *Time*, *Money*, and *Institutional Investor* magazines who is expert in high finance and fascinated by high society. She follows in the FORTUNE tradition of William H. Whyte, author of a 1951 article titled "The Wives of Management" and of a series of stories for our magazine that turned into the *Money* best-seller *The Organization Man*.

Connelly had the idea for the story in this issue when she noticed that a lot has changed since Whyte's day. For one, divorce used to finish a career. No long-

er. More CEOs are remarrying today than ever before. Reporter Darienne Dennis, who worked with Connelly on the story, compiled a table of them. I think you'll find some of the names interesting.

To find out about these marriages, Connelly and Dennis interviewed the wives—as well as first spouses, psychologists, and various academic experts—for hours on end. Applying her networking skills, Connelly would get help from one wife to reach the next and the next. A small world, it turns out. She visited

a few at what she describes as "some of the most beautiful homes in the country," complete with elegant antiques, winding staircases, and soaring ceilings. All the women were eager to talk about their husbands—and themselves.

Perhaps you'll find most intriguing the effect they have on their men and their jobs. Many of the wives are a decade or two younger than their husbands, sometimes several inches taller, beautiful, and very often accomplished. Some try to create the "right" circle of friends by toting their mate to small dinner parties, opera galas, and museum benefits. Some provide moral support for his work. And still others, especially those in their 30s, make the 50- and 60-year-old CEOs feel they can compete sexually with younger men, the kind of ego boost that doesn't hurt when going up against young turks at the office.

Who are these women? What do they have to say? How do they relate to their husband's children? How are they changing their husbands as managers? For answers, see page 52.

Marshall Loeb
MANAGING EDITOR

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vices Group (310,000 subscribers), which sells financial information, Mead (210,000 subscribers), a research-oriented database service, and Prodigy (50,000 households), a joint venture of Sears and IBM that provides home shopping.

Cost has been an obstacle to popularity: from \$12.50 an hour for CompuServe to \$150 to \$300 an hour for Mead's Lexis and Nexis. AT&T could spread billing, marketing, and mailing costs, and help offer the cheap service that would attract a bigger consumer market.

The Goliath admits it needs help. AT&T says its strength is technology. The company concedes a lack of expertise in collecting and collating information and is shopping around for partners in electronic publishing. "The mind-set needed is totally different," says Esther Dyson, editor of *Release 1.0*, a computer industry newsletter. "For AT&T, it's like trying to sell Perrier after being a water utility."

—Rahul Jacob

WEDDING BELLS

■ The usually sedate pharmaceuticals industry will remember the summer of 1989 for its flings and nuptials. The latest betrothal: the planned \$11.5 billion merger of Bristol-Myers and Squibb. This has Wall Street twittering about who else may be headed for the altar. Indeed, wedding bells have barely stopped pealing for the marriages of Marion Laboratories and Dow Chemical, and of SmithKline Beckman and Beecham Group. Now speculators are pushing up prices for shares of the remaining industry eligibles, including Pfizer, Rorer Group, Schering-Plough, Upjohn, and Warner-Lambert.

Is bigger really better in the pharmaceuticals industry?

THE DRUG INDUSTRY'S NEW LINEUP		
LAST FOUR QUARTERS DRUG SALES (in billions)		MAJOR PRODUCTS
1. Merck United States	\$5.67	Yasotec Neovacor
2. Bristol-Myers Squibb United States	\$4.36	Capoten Duricef
3. Glaxo Britain	\$4.10	Zantac Ventolin
4. Hoechst West Germany	\$3.93	Clofran Trital
5. SmithKline Beecham Britain	\$3.79	Tegamet Aspirin

SOURCE: PRUDENTIAL-BACHE SECURITIES (estimated)

Most definitely, say Richard L. Gelb, CEO of Bristol-Myers, and Richard M. Furlaud, CEO of Squibb. The merger will create the world's second-largest drug firm, with 1988 sales of \$8.6 billion and drug revenues of \$4.2 billion. Merck is No. 1 (see table). "We will have the critical mass we need to compete successfully in a global environment," says Gelb, who will head Bristol-Myers Squibb. (For more on the global imperative, see Managing.)

The two executives claim that the new company will leverage Squibb's widely respected research and development operations. For example, instead of licensing a new drug to foreign competitors, Squibb can use Bristol-Myers's financial and marketing prowess to sell it worldwide. The merger also joins Gelb, 65, and Furlaud, 66, who have known each other since their daughters attended prep school together in New York City.

Despite these advantages—and Wall Street's salacious hopes for couplings of any sort—the summer of '89 may also see the end of drug industry



Gelb and Furlaud tie the knot.

romances. Reason: The deals are too expensive. Says Neil Sweig, a drug industry analyst at Prudential-Bache Securities: "Bristol-Myers is paying a price almost beyond belief for Squibb. I think Gelb, before he retires, wanted to vault his company into the ranks of the major pharmaceuticals houses by making a bold move. He let Squibb write its own ticket, and they wrote a beauty." Sweig values the \$11.5 billion stock swap at 4.5 times Squibb's annual sales, eight times book value, and 26 times annual earnings—pricey by any industry's standards.

—Stuart Gannes

BOCCE À LA MODE

■ Not long ago the game of bocce brought to mind images of elderly men smoking Tuscano cigars. It was about as

glamorous as, say, shuffleboard. Now a younger set of devotees swear that bocce (pronounced BOTCH-ee), a cross between billiards and lawn bowling, will surpass golf as an American sport of the 1990s.

The U.S. Bocce Federation estimates that 100,000 Americans are doing it. Californians even play it on the beach. "The beach!" sniffs veteran Paul Montrone, CEO of Wheelabrator Technologies, a waste-to-energy company. "I guess we'll have to be open-minded."

Open-minded he is. For the first time, Montrone has invited a few friends of non-Italian extraction to play in this month's fourth annual Wolfeboro Invitational Bocce Tournament in New Hampshire. Among the newcomers: Sam Zell, chairman of Equity Financial & Management Co.; Ira Stepanian, chairman of First National Bank of Boston; and John Silber, president of Boston University. To get them in the mood, Montrone provided a complimentary copy of *How to Be an Italian*.

—J.L.

Montrone (right) and friend



BUMPY FLIGHT AT MCDONNELL DOUGLAS

Even before two DC-10 crashes, it was beset by defense cutbacks and factory foul-ups. Now managers must unsnarl a new reorganization to get airborne again. ■ by Ronald Henkoff

ONCE AGAIN bad news has jolted McDonnell Douglas. Often enmeshed in controversy and scandal in the 1970s and 1980s, the \$15-billion-a-year aerospace manufacturer must now contend with two fatal accidents, half a world apart, involving its DC-10 airplanes. The first was in Sioux City, Iowa, where 111 people died in a United Airlines crash. Seven days later another 88 people were killed when a fog-encircled Korean Air DC-10 missed the runway in Tripoli, Libya. If investigators determine that design flaws contributed to either accident, it could seriously undermine the already precarious recovery of the company's commercial airplane business.

Publicly, McDonnell Douglas officials express full faith in the DC-10, which has been involved in three other well-publicized crashes in the past 15 years. "From all I've seen, there's been nothing to shake my confidence in the DC-10," CEO John McDonnell told FORTUNE in his first interview since the accidents. After 18 years the company is replacing the DC-10 with a new model and delivered the last one to Nigeria Airways in July.

Even if its plane gets a clean bill of health, McDonnell Douglas has plenty of tough flying ahead. As the nation's largest military supplier (\$8 billion in contracts last year), it historically gets two-thirds of its sales from the government. It is already seeing aircraft programs trimmed away by Pentagon budget cutters, and more reductions are on the runway. Production schedules for all four of its major fighter planes may be stretched out beyond their normal spans, putting a brake on profit margins. Defense Secretary Dick Cheney wants to stop two other programs after fiscal year 1991, the F-15 Eagle attack plane and the Army's AH-64 Apache helicopter, wiping out \$5.2 billion in revenues

REPORTER ASSOCIATE Rosalind Klein Berlin



The 325-seat MD-11, the successor to the DC-10, is due to take off in autumn 1990.

for the company and its subcontractors.

Worse, production bottlenecks and a jarring reorganization are causing losses in its commercial airliner business. Thanks to aggressive salesmanship and a worldwide updraft in air travel, the company's backlog of airplane orders is at an all-time high. But its Douglas Aircraft division, which also makes military cargo planes, has been unable to ramp up production to meet demand. It reported operating losses of \$224 million in the first half of this year.

CEO McDonnell, 51, is convinced that he can put the family-run firm back on course. "Our goal," he asserts, "is to produce higher-quality products at lower cost." That may seem like an obvious objective, but it is a new tack for an organiza-

tion where sales have long dominated manufacturing. McDonnell, a detail-minded manager who sports a neatly trimmed beard, is the son of James S. McDonnell, the legendary "Mr. Mac," who founded the company in 1939 and ran it until his death at 81 in 1980. McDonnell became the top officer at the St. Louis-based company after his cousin, Sanford, retired last year.

McDonnell Douglas reported a loss overall of \$58 million in the first six months of 1989, excluding a one-time gain of \$179 million from an accounting standard change. Cost overruns in airliner production are largely to blame, but the company has also stumbled trying to diversify into less cyclical businesses. Last month it said it would sell off a big chunk of its information

PERFORMANCE

services unit to British Telecom, thereby abandoning hopes of becoming a major player in that field.

The losses come at a bad time. McDonnell Douglas has increased its debt load 41% in the past 18 months to \$2.3 billion, partly to finance the manufacture of its new 325-passenger wide-body jet, the MD-11. The plane, essentially a modernized version of the DC-10, won't be delivered to customers—and therefore won't begin generating revenues—until the autumn of 1990, some three months behind schedule. If the Federal Aviation Administration orders design changes in the MD-11 after the Sioux City crash, certification could be delayed, putting an even greater strain on profits.

Despite its success as a defense contractor, McDonnell Douglas has been bedeviled by the commercial aviation business ever since it took over failing Douglas Aircraft Co. in 1967. During the late 1970s and early 1980s it lost buckets of money as it grappled with stronger competitors and the effects of a DC-10 crash in Chicago in 1979 that killed 273 people, still the worst U.S. aviation disaster. McDonnell Douglas considered getting out of the business in the early 1980s. In 1983, however, James Worsham, a supersalesman who headed the Douglas division, persuaded American Airlines to lease 20 MD-80s on a trial basis. American liked the planes but was especially fond of the bargain-basement terms Worsham offered. The following year American bought 67 more of the 150-passenger aircraft, and McDonnell was back in business to stay—albeit at a cost. According to Phil Friedman, a Drexel Burnham Lambert analyst, low-ball pricing tactics have helped produce cumulative losses of \$200 million in the past decade.

Though it still lags behind competitors



McDonnell promises a brisk turnaround.

Boeing and Airbus (see chart), today the Douglas division has a record order backlog of \$18 billion. The 401 firm orders for the MD-80 are enough to make the production lines at the Douglas plant in Long Beach, California, hum well into 1993. Another 518 options, if exercised, would keep the work force occupied almost to the end of the century. The company has also logged 95 firm orders and 220 options for the MD-11, the new wide-body. Revenues at Douglas could balloon from \$4.9 billion in 1988 to an estimated \$10 billion in 1991.

But after its long famine, Douglas has trouble coping with the feast. "That was probably a more ambitious growth program than they should have committed themselves to," says Paul Nisbet, an aerospace analyst at Prudential-Bache Securities. After a hiring spree between 1984 and 1988 that more than doubled employment to 44,000, Douglas is handicapped by inexperienced workers who require costly training programs. Initial quality has slipped, forcing expensive and time-consuming repair work. Outside suppliers cannot keep pace with increased orders, and Douglas cannot even build enough of its own parts to meet demand. So tangled are the assembly lines that Douglas lost money building the ten-year-old MD-80 in the first half of 1989.

Chairman McDonnell insists the factory problems can be fixed. "Our solution," he explains, "is to change the way we do things." He's not kidding. In January, McDonnell appointed Robert Hood,

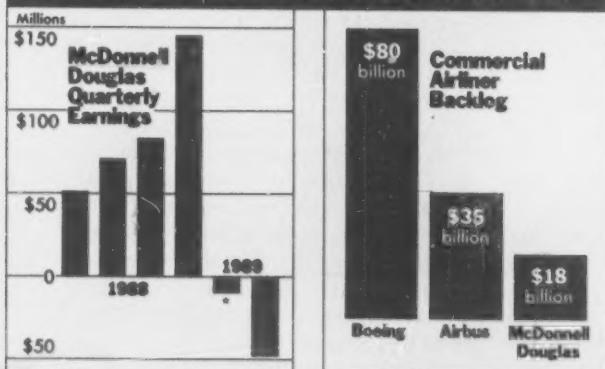
whose forte is manufacturing, to replace the retiring Worsham. Next, the company introduced a sweeping reorganization plan called the Total Quality Management System. It scraps the old functional setup in which engineers worked on several different classes of aircraft and replaces it with a product-oriented system that allows them to focus on a single plane. Every one of Douglas's 5,000 managerial and supervisory positions was eliminated. The former occupants of those jobs can apply for just 2,800 newly created posts. The 2,200 who lose out will be stripped of their line managerial responsibilities. Most will be put to work as technicians on Japanese-style manufacturing teams both in design offices and on the production lines.

McDonnell hopes the reorganization will improve communication, cut bureaucracy, and put an end to what he calls "finger pointing and frustration caused by a lack of authority and accountability." Maybe so, but the execution was clumsy. "They've created chaos," complains Richard Shevell, a former senior engineer at Douglas who is professor emeritus of aeronautics at Stanford. "These kinds of business managers don't care about design or about the wonders of air transport. All they care about is organizational charts." McDonnell Douglas concedes that TQMS has cost more money than it has saved so far.

THE COMPANY also has to win over its often restive blue-collar workers, represented by the machinists and the auto workers unions, who remain suspicious of the managers' talk about teamwork and expanded worker responsibilities. Opposition is especially stiff at the missile systems operations in St. Louis where TQMS has just been introduced. "They've been kicking us in the butt, and now they want to kiss us on the jaw," says Cassell Williams, president of the 12,000-member District 837 of the International Association of Machinists. "They've got to build our trust first before we take them seriously."

By now, McDonnell Douglas is well experienced in coping with crashes, labor problems, and government cutbacks. To date, it has shown an admirable ability for surviving its problems, if not necessarily solving them. The company's current challenge is to sustain its profitable defense business while proving that it can produce and deliver commercial airliners as efficiently as it can sell them.

DESCENDING PROFITS, FEWER ORDERS



*Excludes one-time gain of \$179 million from change in accounting standard.

INCENTIVE PAY THAT DOESN'T WORK

Restricted stock is supposed to spur executives to improve their companies' performance. The author's study shows you can make money betting it won't. ■ by Graef S. Crystal

PSST, BUDDY, want a hot tip on the stock market? Well, whenever a company adopts a restricted-stock plan for its executives, you get out of that stock fast and invest in some other company that doesn't grant restricted stock. You may not make a killing in a single year, but over the long run you're almost sure to beat the market averages.

That advice emerges from a study I recently conducted of 161 major U.S. corporations. These were the companies I analyzed for this magazine's annual survey of CEO compensation (June 5), a group that comprised the top 100 from both the FORTUNE 500 and FORTUNE Service 500, minus companies with negative net worths, foreign corporate owners, or CEOs who served less than a year. Of these 161 companies, 61 grant restricted stock to their CEOs (and probably to other executives too). The remaining 100 do not. In general, the companies that grant restricted stock perform worse than the others, not only in return to shareholders but by a whole range of other measures as well.

What is restricted stock, and why should it be important to investors and not just specialists in executive compensation? To answer that question, let's go back to the 1950s and 1960s, when it was the rare company that used anything other than stock options as long-term incentive compensation. Under a classic stock option grant, the executive received the right, but not the obligation, to buy the company's stock during a ten-year period. The price he was required to pay on exercise of the option (the strike price) was the market value of a share on the day the option was granted. Obviously, if the price rose above that level, he



could exercise his option and sell the shares for an immediate and risk-free gain.

Stock options offer at least some linkage between company performance and executive reward. After all, the executive doesn't make a nickel unless the stock price improves after the grant of his options. On the

other hand, Warren Buffett, keen investor that he is, has observed that executives and shareholders part company when the market declines. The shareholders suffer a fall in the value of stock they bought with real money, while the executive walks away unharmed. That argument is perhaps a bit

GRAEF S. CRYSTAL spent 18 years with a leading compensation consulting firm. Widely considered that industry's dean, he is now a professor at the University of California's Haas School of Business.

REPORTER ASSOCIATE Richard S. Teitelbaum

overdrawn, since the executive does sustain an opportunity loss. But then, an opportunity loss is the same as a real loss only to an economist, and not to the rest of us.

Options may sound pretty good to an executive, but what if the only place his company could compete were for best-of-breed at the local kennel club? What if his company's performance were so leaden that getting its stock price aloft would be like trying to fly the Spruce Goose? Forget about granting stock options, because they are literally not worth the paper they're printed on. But restricted stock—ah, now that looks like the ticket.

WITH RESTRICTED STOCK, the effective strike price is conveniently reduced all the way to zero: The company simply gives the executive the shares with the restriction that he may not sell them for a specified period, generally five years. In the meantime, he gets the dividends and can vote the shares. (Some companies use slight variations, for example offering equivalent sums of cash without issuing actual shares; I considered these the same as restricted stock.) Hence, he no longer has to lie awake nights trying to invent yet another strategy for increasing shareholder returns. To be sure, his stock may be worth more if he does. But even if he doesn't, he can still cash in. Unless he's a real worrywart and gets insomnia over the possibility that his company will go belly up, he can't lose with restricted stock.

Not every company that adopts a restricted stock program is a lousy performer. Witness Paramount Communications and Coca-Cola. Both grant restricted stock to their CEOs, and both have produced superior shareholder returns. But these are exceptions to an overwhelming trend.

For proof, check the table, which shows how the restricted-stock companies in this group underperformed the others. They returned less to shareholders and scored worse in several other important categories, including return on equity and return on assets. Data given are for the past five years, but the time period isn't critical. Look at sales growth or total return to investors for the past three years or the past ten, and the same

THE REAL PRICE OF RESTRICTED STOCK

Companies that award it trailed the rest over five years by these percentages:

Total return to investors	-16%
Sales growth rate	-32%
Net profit margin	-18%
Cash flow margin	-15%
Return on average equity	-28%
Return on average investment	-23%
Return on average assets	-27%
Growth in return on average equity	-11%
Growth in return on average investment	-15%
Growth in return on average assets	-16%

These are results from a study of 161 companies from the FORTUNE 500 and Service 500. An even 100 don't grant restricted stock; the rest, listed below, do.

story comes through: This group is a loser.

Other facts, not reflected in the table, reinforce this conclusion:

■ Not only do the losers earn considerably lower returns on their investment than the winners, but also, as each year passes, they seem to drop even further behind.

■ Growth among the losers, whether in sales, in earnings, or in return on investment, is more volatile. One reason is that

the losers have a higher ratio of debt to equity. If you like to ride on roller coasters, keep your money on the losers. But keep some Roloids handy too.

■ The losers are less able to find profitable ways to reinvest shareholders' earnings, so they pay out more of those earnings in dividends.

■ The market truism about higher risk accompanying higher reward doesn't apply. The winners here earn their higher shareholder returns with exactly the same beta—a measure of stock price volatility, and therefore risk—as the losers.

Why should any of this be? While statistical analysis reveals the trend, it doesn't explain it. But a certain perverse explanation seems apparent. If a company's stock is rising, the board of directors can grant stock options to top executives and expect to see them well rewarded. Even if the stock is falling but directors expect it to turn around, options should pay off. But if the company is going nowhere and directors don't expect much change, then one way to make sure executives will collect on their incentive plan is to give them restricted stock. This assumes, of course, that directors for some reason want to give executives a great deal of money even when the company is performing badly.

That may not make sense. But after 23 years advising boards of hundreds of America's largest corporations, I must report that this is what a lot of directors want to do. In a way, therefore, it makes perfect sense that restricted-stock companies on the whole perform worse than others. That's why they award restricted stock in the first place.

One more thing: The losers pay their CEOs a lot more than the winners. Add together the base salary and bonus of the CEOs and it turns out that the average loser pays 12% more than the average winner. Add together base salary, bonus, and annualized long-term incentive values, and the average loser pays 41% more than the average winner. Now we know at least one reason the losers are losers. They pay their top executives too much.

So don't fall asleep next time you pick up a proxy statement. Read that remuneration section thoroughly. And look for those two little words, restricted stock. There's gold in those words.

COMPANIES STUDIED THAT USE RESTRICTED STOCK

Abbott Laboratories	First Interstate	Nash-Finch
Allied-Signal	Fluor	National Intergroup
AMR	General Dynamics	Nat'l Medical Enterprises
Atlantic Richfield	General Mills	NWA
Avnet	Georgia-Pacific	Occidental Petroleum
Bally Manufacturing	Grayhound	Paramount
BankAmerica	Halliburton	Quaker Oats
Bankers Trust New York	Hewlett-Packard	Ralston Purina
Baxter International	Hospital Corp. of America	RLR Nabisco
Bethlehem Steel	IBM	Santa Fe Southern Pacific
Castle & Cooke	ITT	Scott Paper
Champion International	J.C. Penney	Security Pacific
Chemical Banking	J.P. Morgan	Super Valu Stores
Chevron	Johnson & Johnson	Tenneco
Chrysler	Kroger	Texaco
Citicorp	Manufacturers Hanover	Textron
Coca-Cola	May Dept. Stores	3M
Colgate-Palmolive	McKesson	Unisys
Dow Chemical	Merrill Lynch	W.R. Grace
Dun & Bradstreet	Monsanto	Xerox
	Morgan Stanley Group	